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No. 95-928

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

JOHN W. ATHERTON, JR., *et al.*,

Petitioners,

v.

RESOLUTION TRUST CORPORATION,
IN ITS CAPACITY AS RECEIVER FOR CITY SAVINGS, F.S.B.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF THE AMICI CURIAE AMERICAN BANKERS ASSOCIATION, *et al.*, IN SUPPORT OF PETITIONERS

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ISSUE PRESENTED FOR REVIEW

Whether "federal common law" causes of action by the federal bank regulatory agencies against officers and directors of failed insured institutions survived the enactment of Section 212(k) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. § 1821(k).

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The American Bankers Association, et al., hereby respectfully submit this brief as amici curiae in support of the Petitioner in accordance with the provisions of Rule 37.2 of the Supreme Court Rules. All parties have consented to this filing, and their written consents are filed with this brief.

INTEREST OF THE AMICI CURIAE

This is a case in which the Resolution Trust Corporation (now replaced by the Federal Deposit Insurance Corporation), as receiver, filed suit against the officers and directors of a federally chartered and insured depository institution for damages allegedly caused to the institution and to the receiver by, among other things, the alleged simple negligence of the officers and directors. A federal statute, 12 U.S.C. § 1821(k), authorizes suits by the FDIC against officers and directors for gross negligence. The same statute contains a "savings clause" providing that the statute does not "impair or affect any right of the Corporation under other applicable law." The FDIC contends that it is this clause that permits it to sue for simple negligence, because, the agency says, that is the federal common law standard to which the directors and officers are held.

The American Bankers Association is the largest national trade association of the commercial banking industry in the United States, having member banks located in each of the fifty states and the District of Columbia. Member banks of the Association include national and state-chartered banks, independent and holding company owned banks, and money center, regional and community banks. ABA member banks hold approximately ninety percent of the domestic assets of the American banking industry.

America's Community Bankers is a national trade association for 2000 savings and community financial institutions and related business firms. The industry has more than $1 trillion in assets, 253,000 employees and

14,500 offices. ACB members have diverse business strategies based on consumer financial services, housing finance and community development.

The Bankers Roundtable is a national association whose membership is open to the nation's largest 125 banking companies, which are represented in the Roundtable by the CEOs and highest officers of the companies. The companies hold approximately seventy percent of the country's commercial banking assets, operate in virtually every state and employ almost 1 million individuals. The mission of the Roundtable is to promote the business of banking, to encourage the development of sound banking and financial policies and practices, and to advocate the interests of its member companies in federal legislative, regulatory and judicial fora.

The Independent Bankers Association of America is the national trade association that exclusively represents the interests of community banks. Its membership includes nearly 6000 financial institutions in all fifty states and the District of Columbia.

While none of the Associations include failed institutions or the former officers or directors of such institutions as such in their respective memberships, each Association still has a distinct interest in the resolution of the issues presented by this case. It is clearly in the interests of member institutions of the Associations (not to mention the public interest) that they be served by high quality directors and officers. Having a clearly defined standard of conduct is critical to the recruitment and retention of qualified

officers and directors. Because of decisions such as the one for which review is sought here, present and prospective directors of federally insured institutions necessarily must look over their shoulders and ask themselves hard self-interested questions before agreeing to serve or continue to serve on an institution's board.

Simply put, there is a greater risk of personal--and uninsurable--liability that affixes to directors of insured depository institutions than to directors of other businesses:

o Directors of other businesses are protected by state law "business judgment rules," which elevate the standard of liability in actions against them from simple to gross negligence[1] and thereby guard against liability for errors of judgment made honestly and in good faith. If the Federal Deposit Insurance Corporation and the Third Circuit majority are correct in this case, no such protection is available to directors of federally insured depository institutions. Those directors may be called upon to respond in damages when decisions they make on an informed and reasoned basis turn out badly--as they sometimes do in any business as a result of events beyond anyone's control.

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[1] *See,, e.g. Aronson v. Lewis*, 473 A.2d 805, 812 (Del., 1984); *Auerbach v. Bennett*, 47 N.Y.2d 619, 630-31 (1979); *International Ins. Co. v. Johns*, 874 F.2d 1447, 1458 (11th Cir. 1989)(Florida law); *In re General Tire & Rubber Co. Securities Litigation*, 726 F.2d 1075, 1080 (6th Cir.), *cert. denied*, 469 U.S. 858 (1984)(Ohio law); *Lewis v. Anderson*, 615 F.2d 778, 781 (9th Cir. 1979)(California law).

o Directors of other businesses are not subject to a regulatory regime that is as pervasive as the one that governs federally insured depository institutions.[2] Consequently, directors of other businesses are little affected by a "regulatory exclusion" that might be present in the business's director and officer liability insurance policy.[3] But to a director of an insured financial institution, that is a critical consideration. A regulatory exclusion clause in an insurance contract is a denial of coverage for what is perhaps the most likely type of lawsuit to be filed against a bank or thrift director in the event of a failure of the institution. Even where a liability policy is available without a "regulatory exclusion" provision, the cost of it is prohibitive because the risk of a suit by a regulatory agency is so much greater in the case of the financial industry than in the case of other business.

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[2] "The regulation of banking may be more intensive than the regulation of any other industry, and it is the oldest system of economic regulation." K. Davis, *Administrative Law* § 4.04 at 247 (1st ed. 1958). If anything, it has gotten even more intensive since Professor Davis wrote.

[3] A "regulatory exclusion" is an insurance contract provision that excludes from coverage suits brought by a federal regulator. The validity of such exclusions, with respect to financial institutions' policies, has regularly been upheld by the courts despite arguments of the FDIC and others that a regulatory exclusion is void as against public policy. *See, e.g., Fidelity & Deposit Co. v. Conner*, 973 F.2d 1236 (5th Cir. 1992); *St. Paul Fire & Marine Ins. Co. v. FDIC*, 968 F.2d 695 (8th Cir. 1992); *FDIC v. Aetna Casualty & Surety Co.*, 903 F.2d 1073 (6th Cir. 1990).

Your amici respectfully suggest that the United States Congress drew the proper balance, in 1989, between two important but conflicting objectives. Congress wished to preserve and protect the federal deposit insurance funds by enabling the cognizant federal regulatory agencies to pursue directors and officers of failed institutions for damages under some circumstances. Prior to 1989, at least some states had attempted to insulate directors and officers from such litigation almost entirely, and that was an outcome unpalatable to Congress.[4] Concurrently, Congress did not wish to discourage a willingness on the part of highly qualified and experienced people to serve on the boards of directors of federally insured institutions.[5]

The "compromise" between these competing objectives was the enactment, in 12 U.S.C. § 1821(k), of an explicit national "gross negligence" standard applicable to suits for damages by the banking agencies against the officers and directors of failed institutions. "Gross negligence" is a higher standard of care than would have been permitted under state "insulating" statutes, but a lesser standard of care than "simple negligence."

After four United States Court of Appeals decisions upholding exactly this common sense interpretation of the

[4] *See, e.g.*, 135 Cong. Rec. 7152-53 (Apr. 19, 1989) (Statement by Senator Riegle).

[5] *See* 135 Cong. Rec. 7137 (April 19, 1989)(Statement of Senator Heflin); *accord* 135 Cong. Rec. 7143 (April 19, 1989)(Statement of Senator Sanford).

statute, your amici, their members, the actual or prospective officers and directors of insured institutions, and counsel advising them, all had reason to believe that the law was settled, and that the personal risks of service as a director or officer could be fairly assessed. Now the decision of the Third Circuit below has cast the law once again into a state of disarray and turmoil. Only this Court can set it right again.

REASONS FOR GRANTING THE WRIT

The Petition for Writ of Certiorari filed in this case correctly points out that the decision of the Third Circuit is in direct and irreconcilable conflict with the plain language of 12 U.S.C. Section 1821(k) and with the decisions of four other U.S. Courts of Appeals on the same subject: *RTC v. Gallagher*, 10 F.3d 416 (7th Cir. 1993); *RTC v. Miramon*, 22 F.3d 1357 (5th Cir. 1994); *FDIC v. Bates*, 42 F.3d 369 (6th Cir. 1994); and *RTC v. Frates*, 52 F.3d 295 (10th Cir. 1995).

The Petition likewise points out that the Third Circuit decision below, to the extent that it allows for the continued existence of some sort of "federal common law" simple negligence standard of liability since the enactment of 12 U.S.C. Section 1821(k) as part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989[6] ("FIRREA"), is impossible to square with this Court's 1994 decision in *O'Melveny & Myers v. FDIC*, 114 S. Ct. 2048 (1994). In that case, which arose exactly in the context of

[6] Pub. L. 101-73, 103 Stat. 183 (1989)

FIRREA, this Court applied a familiar doctrine of nearly six decade's standing: "There is no federal general common law." *O'Melveny & Myers v. FDIC*, 114 S. Ct. at 2053 (quoting *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938)).

Your amici concur that those arguments constitute good and sufficient cause to grant the Petition. We appear here to emphasize the importance of the issue, as set forth in the preceding section of this brief, and to raise a related point: the conflict among the circuits created by the decision below extends beyond that discussed in the Petition.

The decision of the court below may best be characterized as one that cannot see the forest for the twigs. The court acknowledges that "Section 1821(k) was enacted as part of FIRREA, a massive 371-page legislative package"[7] that was designed generally to strengthen enforcement powers of the FDIC. Little, if any, mention is made, thereafter, of how Section 1821(k) fits within the detailed enforcement scheme created by that "massive" law. Indeed, in the court's discussion of "The Plain Meaning of the Statute" (57 F.3d at 1237-38, Pet. App. at A-13 - A-15), which is admitted to be "the starting point for interpretation," the court barely acknowledges that the words "gross negligence" appear in the statute at all. Rather, the court focuses almost exclusively upon the "savings clause," a small phrase in a small section of a large bill.

[7] *RTC v. Citifed Financial Corp.*, 57 F.3d 1231, 1239 (3d Cir. 1995), Pet.App. at A-15

The unduly narrow focus of the court continues in its discussion of legislative history. The Petitioners argue (and we agree) that there was a real Congressional concern that FIRREA not be made so onerous as to discourage the best qualified persons from serving as directors of insured financial institutions. They cite for that proposition a statement by Senator Heflin during the debates preceding enactment of the statute. The court below disagreed solely on the grounds that Senator Heflin was talking about a different section of the law at the time. (57 F.3d at 1240 n. 13, Pet. App. at A-19 n.13). That analysis implausibly attributes to Congress (or at least to Senator Heflin) a willingness to discourage service as a director so long as it is not done in the specific section of the law then under discussion.

But it is clear that a proper interpretation of the applicable law here requires its placement in the larger context of FIRREA as a whole. This Court has effectively so held in *O'Melveny & Myers*, *supra*. That case involved, on its facts, a different section of FIRREA than is relevant in this case: Section 1821(d)(2)(A)(i), governing succession by the FDIC to all right, title, power and privilege of the institution for which it is appointed receiver. The FDIC argued there, as it does here, that the specific provision in issue was "nonexclusive" and could be supplemented or modified by federal common law. This Court concluded that such an argument was "demolished" by virtue of the fact that FIRREA, in its other provisions **(including most emphatically the provision directly applicable in this case)** "specifically create[d] special federal rules of decision regarding claims by, and defenses against, the FDIC as

receiver." *O'Melveny & Myers*, 114 S. Ct. at 2054.

Thus the Third Circuit has misapprehended the breadth of the statutory occupation of the field that resulted from the enactment of FIRREA, as definitively construed by this Court. Other circuits have not made the same mistake, thereby raising yet an additional conflict among the circuits created by the decision below.

While the Third Circuit narrowly construes FIRREA's supplanting effect by focusing only on isolated language, three (arguably four) other circuits have applied FIRREA broadly enough so that even the venerable *D'Oench, Duhme* doctrine[8] of "federal common law" is held to have been ousted. While this Court had no occasion to deal specifically with the *D'Oench, Duhme* doctrine in *O'Melveny & Myers*, that latter decision did list the FIRREA "codification" of the doctrine (12 U.S.C. § 1821(d)(9)) as another of the "special federal rules of decision" that, like Section 1821(k), are statutory rules that would be altered, not supplemented, by the addition of a "federal common law" gloss. Subsequent to this Court's *O'Melveny & Myers* decision, the District of Columbia Circuit held that the effect of that decision had been to destroy the grounds for any continuing validity of the common law *D'Oench, Duhme* doctrine. *Murphy v. FDIC*, 61 F.3d 34, 38-39 (D.C. Cir. 1995). In its decision on remand from this Court, the Ninth Circuit agreed, holding specifically that *D'Oench, Duhme & Co. v. FDIC* was one of several named cases that "have now

[8] *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942).

been overruled by the Supreme Court." *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995). The Eighth Circuit likewise agrees, holding "that *O'Melveny* removes the federal common law *D'Oench, Duhme* doctrine and the federal holder in due course doctrine as separate bars to [plaintiff's] defense." *DiVall Insured Income Fund v. Boatmen's First National Bank of Kansas City*, 69 F.3d 1398, 1402 (8th Cir. 1995). Finally, the Seventh Circuit noted (with apparent approval, though not directly so holding) that "several recent cases have suggested that the common law *D'Oench* doctrine did not survive" the enactment of FIRREA, and that that question "is likely to be central to future actions brought by the RTC." *Hillman v. RTC*, 66 F.3d 141, 142 n. 2 (7th Cir. 1995). Similarly, the enactment of FIRREA's Section 1821(k) supplants any previous federal common law standard of care for directors and officers of insured financial institutions.

The Third Circuit's decision below, in its narrow focus upon a single sentence in a massive law, is incompatible with the analyses of its sister circuits.

CONCLUSION

The proper interpretation of 12 U.S.C. Section 1821(k), even in isolation, is, in its own right, a matter of considerable importance to the government, the banking industry, and the public at large. On that discrete question of federal law, there is a conflict among the federal circuits that have considered it. On that alone, this Court should grant the Petition for Writ of Certiorari. But for the reasons set forth above, the more fundamental issue raised by this case, i.e., the extent to which the Financial Institutions Reform, Recovery and Enforcement Act of 1989 occupies the field, to the exclusion of "supplementary" law, necessarily has implications far transcending even that already important question. The guidance of this Court to bench and bar is urgently required. The Petition should be granted.

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